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Taxation issues in family law – a workshop

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TAX LOSSES IN FAMILY LAW

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1. INTRODUCTION

The treatment of a tax loss in property alteration pursuant to the *Family Law Act 1975* (Cth) continues to be uncertain. This state exists regardless of whether a property alteration dispute is compromised with or without the need for a judicial determination. A consistent well practiced treatment for tax losses exists neither in the jurisprudence of the Courts nor in the day to day practice of transactional lawyers negotiating for their clients.

If you were forced to arrive at settled summary of the current state of affairs you would likely conclude that the Court will have regard to tax losses within s 75(2) in an imprecise and arbitrary manner lacking much explanation. You would also be forced to conclude that out of Court, tax losses are most frequently ignored and often deliberately so.

Separating spouses would be better assisted by a more rigorous regard for tax losses. In the best case scenario this would be driven by greater clarity and transparency from the Courts which would demand more predictable treatment of this issue. In the absence of that guidance, advocates before Courts and lawyers in negotiations ought to adopt a more thorough approach to the treatment of tax losses when they arise.

2. TAX LOSS

A 'tax loss' will occur when in any given tax year an individual or entity has allowable deductions that exceed their income (and exempt income). The tax loss will accrue and be available to offset income (including capital gain) in future years.

A 'capital loss' will occur when an asset is disposed of for more than it cost (applying its reduced cost base). If in any year the loss on the disposal of assets exceeds the gains, a 'net capital loss' accrues. This loss will be available to offset capital gains in future years.

It is important not to conflate the two concepts. A 'tax loss' can be offset against income (including income derived from a capital gain). A 'capital loss' can only be accrued and applied against a future capital gain.

Tax losses are not confined to individuals. They have relevance to corporations and can flow through trusts in certain circumstances.

Unsurprisingly, the law is rife with exceptions to the very general description set out above. This summary serves well to provide an overview of the tax regime, but no more. Fundamental to a better treatment of a tax loss in a property alteration is an understanding of the quantum of the loss and the circumstances where it can be deployed for a benefit in the future – which may be limited. This enquiry is the purview of an accountant or a tax lawyer. Legal practitioners without that necessary tax training should focus in the first instance upon identifying whether a tax loss exists, and if so to then engage an expert to better define the nature of the tax loss and the circumstances in which it will produce value.

The value, if any, that rests with a tax loss comprises the tax saved in the future which would otherwise have been levied but for the offsetting against income of the tax loss. In that respect both 'tax losses' and 'capital losses' have a potential to be of value. A tax or capital loss will usually only derive benefit in the future – and even then, only if there is some capital gain or income generated, against which the loss can be offset. They are generally viewed in family law as contingent and speculative. For those reasons they rarely receive much attention in any property settlement adjudication or negotiation. One party will maintain the opportunity to deploy them in the future if the circumstance arises and the other will receive no compensating recognition for the forgone opportunity to share in that benefit.

3. THE COURTS' APPROACH

It is not surprising that there is a limited amount of reported decisions that deal with the treatment of tax losses. Most Australians will live their entire lives without ever needing to know what one is, and will be the better for it. Tax losses only arise where monies have been expended with the intention of producing income, and has failed in that desired purpose. A life without accruing a tax loss is probably a life well lived.

Set out below is a considered summary of a number of decisions where tax losses have variously been taken into account on the balance sheet, taken into account as a s 75(2) factor or ignored. It is trite to say that every case is decided on its own particular facts. The analysis is not made with the intention to criticise any particular decision. The purpose is to identify the present relevant considerations and determine whether those considerations deserve better treatment from case to case or a better enunciation in future jurisprudence.

Trial judges who took the tax loss into account as property

In Nygh J's unreported decision of *Wimborne & Wimborne*[2] his Honour relied on the evidence of two accountants as to the value of tax losses incurred by a company to treat those losses as property. On appeal, the Full Court was not critical of his decision to do so. While the amount and details of how the loss was incurred are unknown, the accountants based their opinions on the taxable income the company was likely to earn in the future against which the tax losses could be offset together with the benefits the husband would be likely to derive from the tax losses having regard to his life expectancy and a section of the *Income Tax (Assessment) Act 1997*

[2] (unreported) Appeals No. EA27/92 & 15/93 judgement dated 28 April 1994.

(Cth). It is interesting to note however that Nygh J included the value of the tax losses at a figure different to that proposed by either accountant. The case might be distinguished from some (but not all) that followed by the fact that in *Wimborne* the tax loss sat within a company. There is a useful discussion to be had about whether a tax loss in a company ought to be considered differently to that which rests with an individual, particularly if that company was attributed with value in the proceedings.

Rose J in *Sabell & Medhurst (No 2)*[3] similarly allowed tax losses in an amount of $103,000 to be treated as part of the property pool (which totalled $3,330,041). The husband was employed in the finance industry and incurred tax losses through a company that he traded through. While the husband was no longer trading and had no intention of doing so, he had years of experience and expertise in the industry. His Honour found that in some years the husband had recorded losses totalling $343,356 which would otherwise have been available to the parties and the children of which there remained an asset of $103,000. It was determined that the tax losses remained "available for financial benefit to the husband in the future especially having continued in the finance industry and the potential accumulation of knowledge and experience which may make it worthwhile for him to resume trading".[4] While Rose J included the tax losses in the property pool available for distribution his Honour did take into account the "current limitations of the tax losses" when determining whether the orders for property distribution were just and equitable.[5] What is interesting about *Sabell & Medhurst* is that the Court accepted that the husband was no longer trading and was not about to resume trading. One might have expected that this evidence supported a low probability of the tax loss ever having a benefit for the husband.

Trial judges who took the tax loss into account as a financial resource

In *Skelley & Skelley*[6] tax credits arose from losses incurred by the husband's company, V Pty Limited, in an unsuccessful farming venture. V Pty Limited acquired a tax loss credit of $600,000 but the relevant amount at trial was $193,644 (the taxable income of V Pty Limited being offset by the necessary part of those tax loss credits over some years). Johnson JR (as his Honour then was) rejected the wife's submission that the losses should be included in the pool available for property as there was no evidence that they had a value of $193,644. His Honour set out a methodology by which a valuation could have been determined[7]:

> …one could consider past average income, have regard to the applicable tax rate and the amount of tax that would be saved, consider the likely future income and

[3] [2011] FamCA 596.
[4] Ibid at [60].
[5] Ibid at [121].
[6] [2010] FamCA 466.
[7] Ibid at [72].

capitalise the credits as a lump sum. One would also apply a discount factor for contingencies.

The husband was the sole owner of the company and continued to earn an income through it. The company had been able to take income, tax free for many years, having offset its taxable income. It was therefore clear that the tax credits were of value to the husband and an adjustment of six per cent was made in the wife's favour pursuant to s 75(2) based on a range of circumstances including the tax credits of V Pty Limited. It is impossible to determine the individual impact of the tax losses. *Skelley* serves as an example of a case where the trial judge clearly did not have before him the evidence required to deal with the tax loss in any manner other than in an obscure and imprecise manner via s 75(2)(o). It is a shame, because in *Skelley* the tax losses had been used to date (and recently) and there was therefore ample evidence of the probability they would continue to be used until exhausted.

In *Woodgrove & Woodgrove*[8] the husband lost a total of $341,400 on four shareholdings. It was accepted that while the husband may be unable to offset future profits on the sale of real estate he would be able to do so against future profits on the sale of shares. The wife submitted that the total amount of $341,400 should be added back to the pool as an asset because the husband would be able to gain a tax advantage from the capital losses in the future. That submission was accepted except for a loss in the amount of $94,000 which reduced the husband's capital gains from the sale of shares in a financial year during which the parties were together (leaving capital losses of $247,400). It was found that the wife would never be able to recover any of the loss of $247,400 to the pool available for distribution which totalled $2,016,020. However once translated into a tax loss the husband had the opportunity to recover some of the loss if he made a profit on the sale of shares in the future and was able to offset the profit against the loss. The trial judge made a one per cent adjustment for tax loss (equal to $20,161). Terry FM concluded[9]:

> No tax loss yet exists and it is very difficult for me to do any precise calculation of how any tax loss will benefit the husband in monetary terms in the future because things such as his marginal tax rate have a bearing. Doing the best I can I intend to make an adjustment in the wife's favour of 1%, which will give her an immediate additional benefit of $20,160.96 in contrast to the potential benefits to the husband in the future once the tax loss crystallised and he actually sells his assets.

In *Connor & Langton*[10] the husband drew a salary from O Pty Ltd of which he was the sole shareholder and director and which had accrued tax losses in the amount of $823,233 (representing about 11.3 per cent of the asset pool available for distribution). A single expert

[8] [2010] FMCAfam 1123
[9] Ibid at [230].
[10] [2012] FamCA 875.

gave evidence that if the assets of O Pty Ltd were sold there would be a deficiency. However, provided the husband continued as the sole shareholder of O Pty Ltd, he could change the company's operations to different investments and enterprises and have the company able to take advantage of the accrued tax losses. There was no evidence that the husband proposed to change the shareholding of the company in the future or wind the company up.

The husband submitted that the Court could have no confidence, based on past performance, that O Pty Ltd would make a meaningful profit in the near future. The wife submitted however that the results of the company for the previous half financial year indicated every sign of moving to substantial profit and the husband's actions over the previous two years indicated he had confidence in the company's profitability. Le Poer Trench J concluded that the tax losses were a valuable resource to the husband and the evidence supported a conclusion that the husband would turn O Pty Ltd to profitability and it was taken into account pursuant to s 75(2). The effect of the tax loss on the adjustment made pursuant to s 75(2) is not capable of calculation.

Similarly in *Hadden & Hadden*[11] the Full Court found no error in the trial judge cancelling out a capital gains tax liability that had arisen from the sale of a property of the parties by future accumulated tax losses. As it was not certain whether the tax losses would ever crystallise the trial judge determined that they were more properly characterised pursuant to a consideration under s 75(2). The wife conceded that she had placed no evidence before the trial judge as to the value of the accumulated tax losses or the capital gains tax resulting in them being unable to be placed on the balance sheet. Further, the wife failed to make any submissions before the trial judge that an adjustment should be made in her favour pursuant to post separation contributions for the tax losses.

Trial judges who did not take the tax loss into account as either property or a financial resource

Tax losses were neither included as property nor treated as a financial resource pursuant to s 75(2) in *Nash & Nash*.[12] Judge Terry had regard to the likelihood of future profit being used to offset against the loss in making that determination. The husband had engaged in share trading and incurred a personal loss in the amount of $4,805,937. However he had not engaged much in share trading in the couple of years prior to trial and did not intend to return share trading, rather he hoped to establish a business. There was no evidence that the tax losses could be offset against income paid from employment should the husband have chosen to go down that path. There was therefore no evidence that it was particularly probable that the husband would be able to make use of the tax losses in the future. Judge Terry distinguished the matter from the circumstances in *Wimborne* (referred to above) and *Cromwell & Cromwell*[13] (referred to below)[14]:

[11] [2012] FamCAFC 184
[12] [2015] FCCA 1359.
[13] [2006] FamCA 1454.
[14] *Nash & Nash* [2015] FCCA 1359 at [230] to [234].

> The case before me is very different. The husband was an employee in his family's business prior to 2006. He has had no paid employment since. He engaged in share trading over a period of about 6 years. He does not seem to have done much share trading in the last couple of years but that is probably because he has had no money to trade with.
>
> If the husband goes back to share-trading using any entitlement he gets from these proceedings and if he is successful he will be able to offset any profits he makes against his tax losses, but while the first might possibly occur the second does not seem highly probable if the past is anything to go by.
>
> …
>
> There was no evidence that it was particularly probable that the husband would be able to make use of the tax losses in the future to achieve a higher disposable income and if I had to make an assessment of probabilities I would rate it as improbable.
>
> I am not persuaded that the tax losses in this case are something I should take into account pursuant to s. 75(2).

The approach taken by the Full Court

The Full Court (Lindenmayer, Nygh and Gee JJ) in *In the marriage of Jacobson, J.L. and Jacobson G.F.*[15] approved the trial judge's decision to ignore tax losses of $10,000 (seven per cent of pool) as property or a financial resource but rather set off the benefit received by the husband against expenses he had incurred.

During the marriage the husband had built a prawn trawler which was owned and operated by the parties in an equal partnership. It was not a financial success. After separation the husband spent a considerable sum on preserving the trawler and applied his share of tax losses incurred during the relationship to do so. The trawler was later sold and the wife received $20,000 of the proceeds. Their Honours upheld the decision of the trial judge to set off the benefit which the husband derived from his utilisation of his share of the partnership tax losses against the expenses incurred by him on the preservation of the trawler after separation for the following reasons[16]:

[15] (1989) FLC 92-003.
[16] Ibid at 77,173.

1. The losses incurred during the marriage were incurred in a partnership of the husband and wife to which the wife contributed;

2. Those losses created a benefit, or a potential benefit, for the parties in the sense that they could be set off against future income so as to reduce tax payable thereon;

3. The husband, after separation, was able to realise part of that benefit to his advantage;

4. The wife had not been able to take advantage of that potential benefit after separation because she had earned no taxable income and there was no more than a remote possibility that she ever would earn sufficient income to be able to take advantage of her share of the losses;

5. Therefore it was just and equitable that the wife should share equally with the husband the benefit which he had derived from the tax losses.

In *JEL and DDF*[17] and *Cromwell* the Full Court approved of tax losses being taken into account as a financial resource pursuant to s 75(2). In *JEL* the loss was incurred by the L Group, a company and trust structure developed by the parties during the marriage (including the JEL Family Trust, the JEL Investment Trust, the L Mining Trust and Bourse Securities through which the parties operated a number of endeavours). The tax losses available principally related to a company established to conduct property development and participate in short term trading investments which would result in a tax benefit of approximately $2.16 million (5.9 per cent of the pool). Having determined that the tax losses of the L Group should be regarded as a financial resource, no further reference was made to the losses by the trial judge. The Full Court (Kay, Holden and Guest JJ) determined that this amounted to an error. Their Honours found that the taxation benefits arising from the tax losses were "too large to ignore" and (discounted for future uncertainties) warranted a further award to the wife of $200,000 to "reflect the advantage the husband has".[18] Of note is that the Full Court found no error in the trial judge treating the tax losses as a financial resource.

In *Cromwell* the husband had carried forward tax losses of about $834,000 (about 5.9 per cent of the asset pool) which were accumulated in the large part during the time the parties were cohabitating. While the evidence was less than clear how it would impact the husband's income in the foreseeable or more distant future, there was no doubt that the husband would "reap the benefits".[19] The losses were likely to significantly absorb outstanding tax liabilities which would have left an excess of the tax losses available to offset against any future income in excess of $125,000. The Full Court (Kay, Warnick and May JJ) upheld the trial judge's finding that to "allow

[17] (2001) FLC 93-075.
[18] Ibid at [179].
[19] *Cromwell & Cromwell* [2006] FamCA 1454 at [13].

the husband to have the sole benefit of losses which accumulated in the main while the parties were together and jointly missing out on income would be unfair to the wife".[20] An adjustment pursuant to s 75(2) was subsequently made in favour of the wife. A five per cent adjustment was made in the wife's favour based on four factors, one of those factors being the husband's carried forward losses

Is a tax loss property?

As is obvious from the discussion of the case law set out above, the more settled view presently is that a 'tax loss' is not property. However, it would be wrong to assume this is a concluded position. Two trial judges have concluded that a tax loss is property (notwithstanding they are in the statistical minority) and the Full Court treatment discussed above does not provide any significant challenge or any consideration to whether the trial judge had made an error in finding that the losses were a financial resource (as opposed to property). The question of the characterisation of a tax loss as property or a financial resource remains open.

The debate is confused, and understandably so, by the prospective and contingent nature of the benefits that will flow from a tax loss. The question ought to be asked, do these contingencies disqualify a tax loss from the definition of property (i.e. the contingency informs the characterisation of a tax loss as property) or does the contingency simply inform the value that is placed on that 'tax loss'. Something should not revert to the species of a financial resource simply because it is difficult to value or even because it has nominal value.

The question was explored in a different context by the Full Court in *Hurst & Weber*[21]. In that case there was a challenge to the finding made by a Federal Magistrate that share options were a financial resource not property. The options had been acquired by the husband in the course of his employment during the parties' marriage. The vesting of the options at future dates were contingent upon the husband continuing employment. If he ceased employment prior to a vesting date, the options were forfeited. In the meantime he could not alienate the options. An expert opined an after tax value with appropriate discounts for the delay in vesting, lack of marketability and performance hurdles in what was described by the expert as the "Monte Carlo" method.[22] There was no discount made for the possibility that the husband might cease employment before the options vested. Despite expert evidence as to an appropriately discounted value (taking into account the contingent nature of options), the Federal Magistrate concluded that the options be treated as a financial resource[23]:

[20] Ibid at [14].
[21] [2009] FamCAFC 137
[22] In fact the expert had rejected the Monte Carlo method and adopted instead the "Black and Scholes" method – but nothing turns on this.
[23] *Hurst & Weber* [2009] FamCAFC 137 at [26].

> However my view is that the shares ought be regarded as a financial resource in the future to the Husband, and not be included in the available pool of assets. The entitlements have not vested and there is nothing the Husband can do to make them vest. He must satisfy certain performance hurdles and particularly maintain his employment. These contingencies shape the quantification of the options, but also support a finding that it is proper to regard this interest as a financial resource rather than a current asset.

Two of the three member bench of the Full Court (Warnick and Boland JJ) rejected the challenge that was made to this finding[24]:

> His Honour did not make a finding that the share options were not property. Had his Honour included the share options as property in the one asset pool he might, even should, have recognised their nature. For that reason, he might even have put them in a separate pool and, in either case, made some adjustment on that account. Rather than take that approach, his Honour did not bring the share options into any pool for division, but rather treated them as a financial resource. We are not prepared to say that that course was not open to him.

It is with respect a curious interpretation by their Honours to take the word "regard" and supplement it with the word "treat". But, even if that was what the Federal Magistrate intended, it did not find favour with his Honour Justice O'Ryan (the third member of the Full Court bench) who while not dissenting in relation to the outcome of the Appeal, in a separate Judgment had this to say[25]:

> If a particular asset is property as defined by s 4 of the Act then it remains property and it cannot be treated as a financial resource.

His Honour concluded that the share options ought to have been included as property and at the value arrived at by the expert. In terms of the contingency of continuing employment (which did not feature in the discount applied by the expert) his Honour advanced the following solution[26]:

> …However assuming there was some relevant aspect of the second of the contingencies being the maintenance of employment then the Federal Magistrate could have taken this into account pursuant to s 75(2)(o) of the Act and explained what he meant and why. He did not do this.

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[24] Ibid at [14].
[25] Ibid at [57].
[26] Ibid at [59].

The difference in opinion of the members of the Court in *Hurst* received some commentary by a later Full Court in *Pittman & Pittman*[27]:

> 59. We also do not propose to express a concluded view on the question as to whether, where there is dispute in property settlement proceedings as to whether a particular asset is property or a financial resource, the trial judge is obliged to determine "definitively" that dispute. In this regard we note the division of opinion on this question between Warnick and Boland JJ on the one hand and O'Ryan J on the other in *Hurst & Weber* [2009] FamCAFC 137.
>
> 60. However, as presently advised, we are of the view that the preferable approach must be that a dispute as to whether or not an asset is property or a financial resource should wherever possible be determined by a trial judge. This is because where an asset is property, proper and adequate consideration of the contributions to such property is required pursuant to s 79(4)(a) and (b), and also because where an asset is property, an order under s 79 can be made with respect to that asset. We recognise, however, that there may be cases where it is either impossible or unnecessary to determine the question of whether an asset is property or a financial resource. But if that is the situation, it should be explained by the judge in his or her reasons.
>
> 61. In this case we consider that the question of whether or not the husband's interest in the PFT constituted property, did require to be answered (given the vast difference in the value of that interest and the value of the parties' other assets, and thus the potential consequences for the contribution assessment and range of available orders)"

The debate is likely further informed by the decision of the High Court of Australia in *Stanford v Stanford*[28] where the majority held[29]:

> First, it is necessary to begin consideration of whether it is just and equitable to make a property settlement order by identifying, according to ordinary common law and equitable principles, the *existing* legal and equitable interests of the parties in the property. So much follows from the text of s 79(1)(a) itself, which refers to "*altering* the interests of the parties to the marriage in the property" (emphasis added).

[27] (2010) FLC 93-430 at 84,660 to 84,661.
[28] (2012) 247 CLR 108.
[29] Ibid at [37].

The interplay between the characterisation of an asset as property and the challenge of valuation received the High Court's attention in *Kennon & Spry*[30] conveniently summarised by French CJ when he said[31]:

> The beneficiary of a non-exhaustive discretionary trust who does not control the trustee directly or indirectly has a right to due consideration and to due administration of the trust but it is difficult to value those rights when the beneficiary has no present entitlement and may never have any entitlement to any part of the income or capital of the trust.
>
> Gummow and Hayne JJ, in their joint reasons, characterise Mrs Spry 's right with respect to the due administration of the Trust as part of her property for the purposes of the *Family Law Ac*t. I respectfully agree with their Honours that prior to the 1998 Instrument the equitable right to due administration of the Trust fund could be taken into account as part of the property of Mrs Spry as a party to the marriage. So too could her equitable entitlement to due consideration in relation to the application of the income and capital. In so agreeing, however, I acknowledge, consistently with the observations of the Full Court in *Hauff* and *Evans*, that it is difficult to put a value on either of these rights though a valuation might not be beyond the actuarial arts in relation to the right to due consideration.

A separate enquiry relates to the inalienability of the tax loss. No Court considering the application of the Family Law Act and the definition of property in s 4 has sought to grapple with a description of the 'right' which attaches to a tax loss in a thorough manner. There is authority for the fact that inalienability itself is not necessarily determinative of whether a right is property or not in some circumstances.[32]

If the challenges of the contingency are relegated to matters of valuation (and not a disqualifying element to its identification as property) the following considerations can be argued in support of the 'property' case.

1. The right to offset income which by reference to the tax loss is legal in nature. It arises within the laws of taxation of the Commonwealth. Its scope is fixed. To adopt the words used by Kent J in *Marlowe-Dawson & Dawson (No.2)*[33] as to one of four qualifying elements for property, the right is recognised by, and enforceable at, law.

[30] (2008) 238 CLR 366.
[31] Ibid at [77] and [78].
[32] A right to sue for damage is not assignable but has been found to be property under the Act; Zorbas (1990) ¶92-160.
[33] [2014] FamCA 599 at [67].

2. A party (or company) owns the right. It vests with them and is particular to them. It cannot be removed (absent a change in legislation) by an arbitrary act by another individual, entity or government. It is legally capable of ownership.

3. The basis of the benefit is fixed. The accrual of a tax loss can be calculated by reference to the law. Indeed, it is required each and every time a tax return is lodged. It is worth mentioning that in other jurisdictions tax assets are often describe as "Deferred Tax Assets". It is common accounting practice to record accruing tax losses in Financial Accounts.

4. Companies 'pregnant' with tax losses are as a matter of commercial practice generally maintained, even if for a rainy day. This occurs often despite the absence of any trading activity in the meantime and the potential continuing registration and administration costs associated with the continued registration of a dormant company. The conduct suggests 'value' of some type resides in the tax loss (at least from an anecdotal commercial sense).

5. In certain circumstances, ownership of a company with accrued tax loss can be altered in a manner which preserves the tax loss for that company in the future.

For a contrary view, there are ample arguments which support the conclusion that a tax loss is a financial resource:

1. While 'inalienability' is not necessarily determinative, the fact remains that an individual cannot assign a tax loss to another person;

2. The property is not the accrued loss, but the right to offset it against income to reduce tax and that right does not come into existence until the income has been earned.[34]

3. Given future income is not property[35] and tax credits against that income are just a consequence of that future income, then tax credits cannot be property either.

The dilemma might be better understood in context by exploring two extreme alternatives. If a party had accumulated tax losses of $2 million and was at the time of trial gainfully employed earning an income of $500,000 per annum, that party could expect future tax savings in the sum of $1 million across the next four years. Consider the effect that characterisation of the tax loss as property would have if the pool of property otherwise available for alteration was $5 million compared with if that pool was only $1 million. Again consider if the pool was further reduced for

[34] There is an interesting and likely irrelevant consideration to be made as to whether the right comes into existence when the income has been earned or when the tax is assessed (or perhaps capable of being assessed). The consideration and absurdity of some of the variations of these outcomes may in fact support the concept that the right in fact arose when the tax loss was incurred and not when the income was earned or tax assessment made.

[35] *Marlowe-Dawson & Dawson (No. 2)* [2014] FamCA 599 at [52].

the sake of the exercise to $500,000 (which might require a regime of future payments out of future income to settle the property between the parties).

A step further

If a tax loss was found to be property, could a Court pursuant to s 79 alter that property and assign the tax loss from one party to the other? Or to borrow some recent language of the Full Court, substitute one tax payer for the other. The power to alter 'property' exists in s 79. The general powers in s 80 includes the very broad sub-section 80(k) which provides:

> make any other order (whether or not of the same nature as those mentioned in the preceding paragraphs of this section), which it thinks it is necessary to make to do justice;

The power is enhanced by s 90AE and in particular s 90AE(2) which provides:

> In proceedings under section 79, the court may make any other order that:
> (a) directs a third party to do a thing in relation to the property of a party to the marriage; or
> (b) alters the rights, liabilities or property interests of a third party in relation to the marriage.

If afforded the requisite procedural fairness and after properly considering the mandatory requirements of s 90AE(3) could an order be made requiring the ATO to transfer the tax losses of one party to another. Would any special characteristics of that loss which limited its deployment against only certain income be preserved as part of the transfer? Could such an order transfer tax losses in one corporate entity to another? Are franking credits so different to a tax loss in that scenario and if not could the same approach see franking credits transferred from one company to another?

In the *Commissioner of Taxation v Tomaras*[36] the High Court confirmed the power in s 90AE to assign tax liability between parties in aid of s 79. The case is distinguishable given that it considered a tax liability and not a tax credit like a tax loss. However, it is ample authority for the fact that s 90AE is binding on the Commonwealth. It relegates the application of s 90AE to the question of whether or not a tax loss is property.

Even if there is a legislative pathway to the substitution of one tax payer for another in terms of tax losses – it is likely to face significant discretionary challenges. The Court would need to be persuaded that the substitution was necessary to do justice between the parties. Absent, that scrutiny the substitution powers could be readily abused to the detriment of Commonwealth.

[36] [2018] HCA62

It should be considered that the matters discussed above deserve far more significant consideration than what can be afforded to it in a paper focused on current approaches to the treatment of tax loss. The discussion above is preliminary in nature and high level at best

The likely relevant considerations

The decided cases set out above, unsurprisingly, demonstrate that the treatment of a tax loss may vary depending upon the circumstances of the case. Any consideration of the treatment of a tax loss will need to take into account an informed understanding of a range of matters. Some of the cases discussed above have turned on the absence of evidence being put before the trial judge in relation to those matters. It is premature to exclude as irrelevant a tax loss without a consideration of these matters.

1. *The present value of the tax loss.* This should be easily capable of calculation on the assumption there presently exists income against which to offset the loss and avoid tax. It is a starting point and nothing more, but important nonetheless. It will include an understanding of whether the loss can be offset against income (and capital gain) or just capital gain. This is a matter for expert evidence.

2. *The likelihood of future income against which to offset the tax loss*. Unless the potential for future income can be demonstrated a Court is unlikely to assign value to the tax loss be it regarded as property or financial resource. The more predictable future income that qualifies to absorb the tax loss the more relevance the issue will have to the property alteration. Many of the cases discussed above turn on this fact and it should be an obvious matter to consider. However, too often it is dealt with in a cursory manner. Properly considered, this would include details of current income, past income, age, capacity for continued income, necessity for future income and of course the likely rate of that income from year to year. This is a matter for lay evidence but in appropriate cases might but supplemented by expert evidence in relation to remuneration, employability or profitability.

3. *Discount that ought to be applied to the value of the benefit.* The raw benefit will need to be discounted for the present value of that benefit based on the time that will elapse before it is obtained.

4. *The circumstances in which the tax loss arose*. This evidence has featured heavily in a number of cases. It is not a matter which should be discounted out of hand. Whether the tax loss arose during the relationship and whether it exposed the whole family to disadvantage are matters which have informed the Court’s approach to date in some cases.

5. *The proportion of the benefit to the financial circumstances of the parties*. The approach to a tax loss which produces a benefit equal to five per cent of the rest of the parties' wealth will have a different significance to a benefit equal to 50 per cent of that wealth.

Conclusion

There is ample scope for argument, assessed case by case, about the treatment of tax losses. There are evidentiary pathways revealed in the decided cases to date that have not yet been utilised to the fullest extent. A well-argued case for a more proper treatment of tax losses should yield benefits before a Court or in a negotiated environment be it found to be property, a financial resource and even if the value is heavily discounted.